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Supreme Court of the United States

OCTOBER TERM, 1966.

No. 1192

R. E. KELLERMAN, TED WEINER and NICHOLS & COMPANY,

Petitioners,

versus

PRESTON J. MILLER,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

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INDEX.

	Page
OPINIONS BELOW	1
JURISDICTION	2
QUESTIONS PRESENTED	2
STATUTE INVOLVED	3
STATEMENT OF FACTS	3
REASONS FOR GRANTING THE WRIT	7
A. THE COURT OF APPEALS ERRED IN NOT GIVING THE SAME EFFECT TO THE ORDER OF THE COMMISSIONER OF CONSERVATION THAT WOULD HAVE BEEN GIVEN TO THE ORDER BY THE LOUISIANA COURTS	10
B. THE COURT OF APPEALS ERRED IN HOLDING THAT SUFFICIENT RENTALS WERE NOT PAID PRIOR TO MAY 5, 1958 TO MAINTAIN THE ENTIRE LEASE IN FORCE, BUT, IN ANY EVENT, AT LEAST THE NORTH HALF OF THE LEASE WAS MAINTAINED BY ITS INCLUSION IN THE CONSERVATION UNIT AROUND THE SHUT-IN GAS WELL	19

INDEX—(Continued):

Page

C. IF KELLERMAN FAILED TO PAY THE CORRECT RENTAL, THE COURT OF APPEALS ERRED IN REFUSING TO LET KELLERMAN CORRECT THE ERROR OR, IN THE ALTERNATIVE, IN REFUSING TO HOLD THAT MILLER HAD WAIVED HIS RIGHT TO HAVE THE LEASE CANCELLED BY REMAINING SILENT FOR ALMOST FIVE YEARS AFTER ACCEPTING PAYMENT OF THE DELAY RENTAL 25

CONCLUSION 33

APPENDIX:

STATUTE INVOLVED 35

PER CURIAM OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT 36

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT 39

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT, DENYING PETITIONERS' PETITION FOR REHEARING AND REHEARING *EN BANC* 41

CITATIONS.

Page

Cases:

Delatte v. Woods, 94 So.2d 281 (La.S.Ct. 1957) 10-15, 18-21, 24, 25, 28, 30, 32

Dellinger v. Smith, 77 So. 947 (La.S.Ct. 1918) .. 31

Erie Railroad Co. v. Tompkins, 304 U.S. 78 32

Fidelity Union Trust Company v. Field, 311 U.S. 169 9

Jones v. Southern Natural Gas Company, 36 So.2d 34 (La.S.Ct. 1948) 3, 26-31

Landry v. Flaitz, 157 So.2d 892 (La.S.Ct. 1963) 14

Risinger v. Arkansas-Louisiana Gas Co., 3 So.2d 289 (La.S.Ct. 1941) 31

Smith v. Carter Oil Co., 104 F.Supp. 463 (W.D.La. 1952) 23

Sohio Petroleum Co. v. V.S. & P.R.R., 62 So.2d 615 (La.S.Ct. 1952) 10, 11, 15, 19, 21, 24, 25, 28, 30, 32

Thompson v. City of Louisville, 362 U.S. 199 9

Wilcox v. Shell Oil Company, 76 So.2d 416 (La.S.Ct. 1954) 18

Statutes:

28 U.S.C. 1254(1) 2

United States Supreme Court Rule 19(b) 9

LSA-R.S. 30:9(B) 3, 8, 14, 25, 31, 35

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R. E. KELLERMAN; TED WEINER and NICHOLS & COMPANY,

Petitioners,

versus

PRESTON J. MILLER,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Petitioners, R. E. Kellerman, Ted Weiner and Nichols & Company, Inc. (hereafter called "Kellerman"), pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals, Fifth Circuit, entered on December 16, 1965 in the above entitled case. That judgment affirmed, *per curiam*, a judgment of the United States District Court for the Western District of Louisiana, cancelling an oil and gas lease on the grounds that lessee had failed to pay the proper delay rental.

OPINIONS BELOW.

The opinion of the United States District Court for the Western District of Louisiana (Hunter, J.) (R. 179), is reported at 228 F. Supp. 446 (1964). The opin-

ion of the Court of Appeals *(per curiam)* is reported at 354 F.2d 46 (1965) and appears in the Appendix hereto at page 36. The judgment of the Court of Appeals appears in the Appendix hereto at page 39, and the order of the Court of Appeals denying petitioners' petition for rehearing and rehearing *en banc* is reported at 354 F.2d 46 (1966), and appears in the Appendix at page 41.

JURISDICTION.

The opinion and judgment of the Court of Appeals for the Fifth Circuit were filed on December 16, 1965. Petitioners' timely petition for a rehearing and rehearing *en banc* was denied by that Court on January 25, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED.

1. Whether an order of the Conservation Commission of Louisiana superseded the provisions of an oil and gas lease with the result that the inclusion of a portion of the lease in a unit around a shut-in gas well held the entire lease during the primary term without the payment of any delay rental.

2. Whether the lease contained a Pugh clause which divided the lease into two leases with the result that delay rentals were due on the portion of the lease outside the Conservation Unit.

3. Whether, if the lease contained a Pugh clause, the amount of delay rental was so uncertain as to require the application of the doctrine of *Jones v. Southern Natural Gas Company*, 36 So.2d 34 (La. S.Ct. 1948), which held that where the lessee made a reasonable mistake in the payment of delay rental, he should be given an opportunity, after notice of the error, to correct the mistake.

4. Whether Miller, by remaining silent for almost five years after accepting the rental payment and failing to question the correctness of the rental payment until almost three years after every acre of the lease had been participating in the production, had waived his right to have the lease cancelled for non-payment of delay rental.

STATUTE INVOLVED.

The statute involved is the Louisiana Conservation Statute (LSA-R.S. 30:9, subd. B) which is printed in the Appendix hereto at page 35.

STATEMENT OF FACTS.

This is a dispute between private parties. The facts are not in dispute and were stipulated by the parties in the District Court. Respondent, Preston J. Miller, granted an oil and gas lease to petitioner, R. E. Kellerman, who assigned interests in the lease to petitioners Ted Weiner and Nichols & Company, Inc. Petitioners will hereafter be referred to as

"Kellerman." The Miller Lease provides for a primary term of three years commencing May 5, 1956. It contains the customary "unless clause" providing for its termination at the end of the first year unless the lessee commenced the "drilling (spudding in) of a well on the land, or on acreage pooled therewith" or paid a delay rental of $3,900 which payment would keep the lease in effect until May 5, 1958. This paragraph further provides that the lessee can maintain the lease for another year or until May 5, 1959, without drilling, by paying a delay rental.

On March 4, 1957, the Ohio Oil Company commenced drilling the Durke well approximately 2,440 feet north of the Miller Lease. Conservation Order 367, effective March 13, 1957, established a drilling unit around the Durke well, which unit included the north half of the Miller Lease. This is a most important fact because the failure of the Court of Appeals to give the same effect to the Conservation Order that would have been given to the order by the Louisiana Supreme Court resulted in the judgment which deprived Kellerman of property of great value. The same order established a drilling unit including the south half of the Miller Lease. The Durke well was completed as a gas well on April 12, 1957 and was shut in until May 25, 1958. On April 20, 1957, Kellerman paid Miller $3,900 as the annual delay rental for the period May 5, 1957 to May 5, 1958 and on April 23, 1958, Kellerman paid Miller $3,900 as the delay rental for the period May 5, 1958 to May 5, 1959, which payment was accepted by Miller and retained until March 28, 1963. (R. 43.)

On July 19, 1958, The Superior Oil Company commenced drilling the Bernard well approximately 390 feet west of the Miller Lease on a unit including the south half of the Miller Lease. The Bernard well was completed on September 4, 1958 and was placed on production during November, 1958. Thus, as of November, 1958, all of the land covered by the Miller Lease was included in conservation units around producing gas wells and was participating in production from the Durke well and the Bernard well. (R. 45-46, 169-173.)

After participating in the production from the Durke well and from the Bernard well for more than 3-1/2 years and while every acre of the Miller Lease was still productive (R. 169-173), Miller addressed a letter to Kellerman on November 16, 1961, demanding that the Miller Lease be released. (R. 49.) When Kellerman refused to comply with Miller's demand, Miller filed suit for cancellation of the lease for breach of drilling obligations on December 28, 1961 in the Fifteenth Judicial District Court in and for the Parish of Vermilion, Louisiana, which suit was removed to the United States District Court for the Western District of Louisiana on January 18, 1962. (R. 49-50.)

Over 14 months after the suit was filed, Miller, on March 19, 1963, filed an amended complaint alleging as an additional ground for the cancellation of the lease:

> "That plaintiff was paid only $3,900 by April 23, 1958, check drawn on the Bank of Commerce of Fort Worth, Texas, by 'Ted Weiner operator'

and that the balance of the $7,800.00 delay rental due on or before May 5, 1958, under the terms of the lease was not tendered to plaintiff." (R. 29.)

By letter dated March 28, 1963, Miller, through his attorney, transmitted his check to Kellerman in the amount of $3,900, as a refund of the delay rental payment made on April 23, 1958, for the period May 5, 1958 to May 5, 1959. Miller claimed in the letter of transmittal that the rental due as of May 5, 1958 was $7,800 instead of $3,900. (R. 175-176.) By letter dated April 3, 1963, Texas Crude Oil Company, acting on behalf of Kellerman, returned Miller's check in the amount of $3,900 and, in addition, delivered to Miller its check for $3,900 as an additional rental payment for the period May 5, 1958 to May 5, 1959, making a total of $7,800, with the explanation that Kellerman did not believe any additional rental was due and with reservation of the right to have a judicial determination as to the proper amount of delay rental due for the period May 5, 1958 to May 5, 1959. (R. 43; 177-178.)

The District Court rendered judgment on March 19, 1964, decreeing that the Miller Lease had terminated on May 5, 1958 because of non-payment of the proper amount of rental on or prior to that date. (R. 203, 219.)

Kellerman filed a motion for a new trial, which the District Court denied. Kellerman appealed to the Fifth Circuit Court of Appeals which, in a *per curiam*, affirmed the judgment of the District Court. Kellerman applied for a rehearing and a rehearing *en banc*

which the Fifth Circuit Court of Appeals denied on January 25, 1966, without reasons.

REASONS FOR GRANTING THE WRIT.

The basic issue presented by this case is whether or not the inclusion of the north half of the Miller Lease in a conservation unit around a shut-in gas well maintained the lease in force without the payment of delay rentals by the lessee. In Louisiana, the usual oil and gas lease provides for the payment of a sum of money called a bonus which maintains the lease in force for one year from its date. The lease also contains a clause known as the "unless clause" which provides that the lease will terminate at the end of one year unless the lessee either commences operations for the drilling of a well or pays a sum of money known as "delay rental" for the privilege of maintaining the lease in force for one more year without drilling a well. This privilege may be exercised each year during the primary term of the lease, which is the fixed number of years the lease may be held without production.

Louisiana, as one of the leading producers of oil and gas in the United States, has long recognized the necessity of conserving the State's natural resources. Commencing in the early years of the oil and gas industry, the Louisiana Legislature has adopted numerous statutes designed to avoid wasteful practices in the production of oil and gas. In 1940, the Louisiana Legislature adopted Act 157, known as The Oil and Gas Conservation Law of Louisiana. For the first time the Commissioner of Con-

servation was given adequate authority to prevent economic waste resulting from the drilling of unnecessary wells by combining or pooling separately-owned tracts of land or portions thereof into a single drilling unit and prohibiting the drilling of more than one well on the conservation unit thus created. Under the statute, the land included in such a unit "shall constitute a developed area as long as a well is located thereon which is capable of producing oil or gas in paying quantities." LSA-R.S. 30:9(B). It is the settled jurisprudence of Louisiana, based on this provision of the Conservation Statute, that the inclusion of a portion of the leased land in a unit around a shut-in gas well established by an order of the Commissioner of Conservation maintains the lease in effect until the end of the primary term without the payment of any delay rental. Although this provision of the Louisiana Conservation Statute and the cases of the Louisiana Supreme Court holding that the inclusion of a portion of a lease in a conservation unit around a shut-in gas well maintains the lease in effect without the payment of delay rentals were called to the attention of the District Court and the Court of Appeals, the District Court, without discussing the authorities relied on by Kellerman, rendered a judgment cancelling the lease for non-payment of delay rental and the Court of Appeals affirmed the judgment in a *per curiam* with the statements that:

> "* * * Under the requirements of the *Erie* doctrine, we must make the best guess possible as to the applicable law of the State of Louisiana.* * *

> "We have reached the conclusion that the trial court made a proper interpretation of the lease as to the payment of delay rentals and the default of the appellant-lessees in failing to make such payments according to the terms of the lease. We are unable to render any more reasonable interpretation of the lease after a meticulous consideration of the other possible interpretations of its provisions. * * *"

The error committed by the District Court and the Court of Appeals was their failure to recognize that the provisions of the lease were superseded by the order of the Conservation Commission under the settled jurisprudence of Louisiana.

The judgment rendered by the Court of Appeals has resulted in a gross miscarriage of justice in that it has deprived Kellerman of a producing oil and gas lease of great value. If the case had been tried in the Louisiana courts, this miscarriage of justice would not have occurred. If the judgment of the Court of Appeals is permitted to stand, those lessors who are able to litigate their disputes in the federal courts will be able to avoid the effect of an order of the Louisiana Commissioner of Conservation on the rental-paying provisions of their leases. In the past, this Court has granted writs of certiorari to review decisions of the United States Courts of Appeals under such circumstances pursuant to Supreme Court Rule 19(b). *Thompson v. City of Louisville,* 362 U.S. 199; *Fidelity Union Trust Company v. Field,* 311 U.S. 169. The Court of Appeals, by refusing to follow settled Louisiana law, has deprived petitioner of property of great value in a manner which urgently requires correction.

A. THE COURT OF APPEALS ERRED IN NOT GIVING THE SAME EFFECT TO THE ORDER OF THE COMMISSIONER OF CONSERVATION THAT WOULD HAVE BEEN GIVEN TO THE ORDER BY THE LOUISIANA COURTS.

The law is well settled in Louisiana that orders of the Commissioner of Conservation relating to drilling and production of oil are paramount, become the law of the case, and govern the rights and obligations of the parties despite conventional contractual obligations between the landowners and lessees. *Sohio Petroleum Company v. V. S. & P.R.R.*, 62 So.2d 615 (La. S.Ct. 1952); *Delatte v. Woods*, 94 So.2d 281 (La. S.Ct. 1957).

In the *Sohio* case, *supra*, the lease commenced on July 6, 1946 and contained the usual "unless clause" which provided that the lease would terminate on July 6, 1947, unless on or before such date the lessee either commenced the drilling of a well on the leased premises or paid a delay rental which would keep the lease in force for another year without drilling. The lessee paid no delay rental for the year commencing July 6, 1947. However, prior thereto the Commissioner of Conservation of Louisiana issued an order effective May 31, 1945, establishing a drilling unit including the leased premises and, in August, 1946, the drilling of a well was commenced on the unit but not on the leased premises. This well was completed and was capped on October 11, 1946, approximately nine months prior to the rental paying date. In 1950 the lessor sued to cancel the lease on the grounds that no drilling had been commenced

on the leased premises and no delay rental had been paid on or before July 6, 1947. The Louisiana Supreme Court refused to grant cancellation of the lease because of the lessee's failure to commence drilling or pay a delay rental before July 6, 1947 as required by the express provisions of the lease. The reason why the Louisiana Court refused to cancel any portion of the lease was because a portion of the lease had been included in a unit around a shut-in well by an order of the Commissioner of Conservation prior to the rental paying date. In reaching this conclusion, the Court stated:

> "Consequently, when the Kingwood-Jones No. 1 well was completed as a well capable of producing gas in paying quantities, within the year provided in the lease, *the area forming this drilling unit was considered to be a developed area within the meaning and contemplation of the act, and Article 5 of the lease is inapplicable.* In fact, another well could not have been drilled on this same unit without specific authorization, as secured in this case, i.e., by obtaining an order from the Commissioner of Conservation, following a full hearing and based upon his findings, warranting such exception to basic Order No. 96. It necessarily follows that the lease did not terminate for failure to pay rentals." *Sohio* case, *supra*, p. 620. (Emphasis supplied.)

The *Delatte* case, *supra*, presented a similar factual situation. On October 21, 1953, two days before the end of the primary term, the lessor and lessee entered into an agreement extending the lease for

one additional year commencing October 24, 1953, with a provision that the lease would terminate on November 24, 1953, unless the lessee commenced drilling on the leased premises or paid a delay rental of $1,000, which would extend for one month the time during which actual drilling may be commenced, with a further deferment of the commencement of drilling operations each month thereafter during the time as extended by the payment of said monthly delay rental. Prior to the execution of the amendment to the original lease on April 20, 1953, a gas well had been drilled, completed and shut-in by a third party on property adjacent to the leased premises. The Commissioner of Conservation of Louisiana issued an order, effective August 1, 1954, establishing a unit around the shut-in gas well on the adjacent property, which unit included a portion of the leased premises. The lessor sued to cancel the lease on the grounds that the inclusion of a portion of the leased premises in the unit around the shut-in well on the adjacent property did not satisfy the drilling or rental paying provisions of the agreement amending the original lease. In refusing to cancel the lease, the Court said:

> "Thus, the sole question before us is whether the basic Order No. 280-A of the Commissioner of Conservation, unitizing a portion of the leased land with other lands, designating Well No. 2 as the unit well, and limiting said unit to one well, constituted a production of oil, gas or other minerals affecting all lands within the said unit and thus relieved the defendant of any drilling operations towards production or the 'spudding

in' or commencement of actual drilling on any portion of the entire leased premises so as to have kept in full force and effect the lease here in controversy. We are constrained to hold in the affirmative.

* * *

"* * * The primary cause urged by all of the plaintiffs for the cancellation of their lease is that the unitization of a portion of the leased premises did not prevent or relieve the defendant Woods from the performance of the drilling obligation which he expressly assumed.

"It is firmly established in our jurisprudence that statutory authority is granted to the Commissioner of Conservation to create drilling developmental units and to integrate various tracts of various owners contained in such units, that the orders of the Commission supersede, supplement, replace and are incorporated in the provisions and obligations of contracts and leases relating to mineral development. LSA-R.S. 30:1 et seq. It necessarily follows that these orders become the law as between the parties in determining their respective rights and obligations.

"Sec. 8(b) of Act 157 of 1940, as amended, LSA-R.S. 30:9(B), authorizes the commissioner to establish drilling units so as to prevent waste and to avoid the drilling of unnecessary wells. The unit contemplated means the maximum area that might be efficiently and economically drained by one well, the owner of such tracts to share rateably according to their ownership. Such units constitute a developed area as long as a

well is located therein which is capable of producing oil or gas in paying quantities.

* * *

"Under these circumstances Unit B in which a portion of the leased premises was embraced constituted a developed area as defined by the conservation statute, supra, and therefore defendant Woods was relieved from any drilling obligation called for by his lease as extended on that portion of the leased premises embraced within said Unit B." *Delatte v. Woods, supra,* pp. 286-288.

The significance of the decisions in the above two cases is that the provisions of the leases were superseded by the orders of the Commissioner of Conservation which became the law as between the parties in determining their respective rights and obligations. Thus the lease provisions requiring the payment of delay rentals or the commencement of drilling operations to maintain the lease in effect were dispensed with because of the specific language of the Conservation Statute stating that the portion of the lease within the conservation unit constituted "a developed area as long as a well is located thereon which is capable of producing oil or gas in paying quantities." LSA-R.S. 30:9(B). The only limitation on the length of time the unitized area constitutes a developed area without production is found in *Landry v. Flaitz,* 157 So.2d 892 (La. S.Ct. 1963) which limited the effect of the inclusion of a portion of a lease in a conservation unit to the primary term of the lease and held that despite the conservation order

production was necessary to maintain the lease after the primary term.

The primary term of the Miller lease ended on May 5, 1959 but long prior to that date the well on the unit including the north half of the Miller Lease and the well on the unit including the south half of the Miller Lease were placed on production (R. 45, 46) and thereafter the lease was held by production pursuant to Paragraph 2 of the lease. (R. 60, 61.)

In the *Delatte* case, *supra,* the court held that the inclusion of a portion of a lease in a conservation unit on which there was a shut-in well maintained the lease in its entirety, both as to the acreage within the unit and as to the acreage outside the unit because the lease contained no express provision to the contrary. In the words of the Court, this holding was "based on the fundamental proposition well established in our jurisprudence that the lessee's obligation to drill a well is indivisable in its nature and the lessor's corresponding obligation to deliver the land is also indivisable, with the result that if the obligation of one is fulfilled in its entirety, then the obligation of the other is also fulfilled in its entirety." *Delatte v. Woods,* 94 So.2d 281, 288.

Under the Erie doctrine, the Court of Appeals was obligated to give the same effect to the order of the Commissioner of Conservation in this case as the Louisiana courts gave to the orders of the Commissioner of Conservation in the *Sohio* and *Delatte* cases. Consequently the Court of Appeals was obligated to recognize that the order of the

Commissioner of Conservation placing the north half of the lease in a unit around the Durke well, prior to the May 5, 1957 rental-paying date, superseded the delay rental provision and the drilling provisions of the lease and maintained the lease in force for the balance of the primary term without the payment of delay rentals or the conduct of drilling operations, both as to the area within the unit and as to the area outside the unit because there is no express language in the lease which changed the effect of the Conservation Order unless Paragraph 9 of the lease contained such language, which is denied for the reasons hereinafter stated.

The pooling of various leases, or portions thereof, to form a unit for the drilling of a single well by an order of the Commissioner of Conservation, pursuant to the Louisiana Oil and Gas Conservation Statute, proved so effective in preventing the drilling of unnecessary wells that lessees generally do not care to take a lease without an adequate and proper pooling clause which permits the lessee to join with other lessees in the formation of a voluntary unit with the same beneficial results for the lessee as a compulsory unit created by an order of the Commissioner of Conservation. The usual pooling clause gives the lessee the authority to pool or unitize the lease, or portions thereof, with other leases for the production of oil and gas, limits the acreage that may be included in such units and contains a stipulation that drilling operations on and production from any part of the pooled unit shall be treated as if such operations were on and production was from the land described in the lease regardless of whether or not the

well is located on the land covered by the lease. The commencement of a well on land in such a voluntary unit, even though not on the lessee's land, prior to a rental-paying date will maintain the lease in force without the payment of any delay rental. Since these pooling clauses vary from lease to lease, depending on the desires of the parties, a considerable body of jurisprudence has developed on the question of whether the formation of a voluntary unit was in strict compliance with the provisions of the pooling clause so that a well drilled on land in the unit but not on the leased premises will have the same effect as a well drilled on the leased premises and will maintain the lease in force without the payment of any rentals as long as the well continues to produce. It should be noted that in the case of a voluntary unit, the well must be produced to maintain the lease without the payment of rentals whereas in a compulsory unit created by an order of the Conservation Commission, the existence of a shut-in well on the unit will maintain the lease, a portion of which is in the unit, without production because of the specific language of the conservation statute. This discussion of voluntary unitization is necessary in order to show the fallacy of the reasoning of the District Court and the Court of Appeals. The District Court held that the inclusion of the north half of the Miller Lease in the conservation unit around the Durke well did not maintain the lease in force without the payment of delay rental because under the specific language of Paragraph 3 of the Miller Lease only a well drilled by the lessee on a conservation unit established prior to the commencement of drilling would maintain the lease in force without the payment of delay rent-

al. The District Court relied on the decision of the Louisiana Supreme Court in *Wilcox v. Shell Oil Company*, 76 So.2d 416 (La. S.Ct. 1954), which dealt with a voluntary unit as distinguished from a compulsory unit created by an order of the Conservation Commission. As pointed out by the Louisiana Supreme Court in *Delatte v. Woods, supra,* the holding in the *Wilcox* case has no application to a compulsory unit established by the Commissioner of Conservation. In that case, the Louisiana Supreme Court said:

"Plaintiffs place great reliance in the case of Wilcox v. Shell Oil Company, 226 La. 417, 76 So. 2d 416, as the basis for distinguishing the instant case from the decisions of this Court dealing with the effect of operations on or production from a unit area.

"The Wilcox case, supra, is readily distinguishable from the instant case. This distinction lies in the fact that the former case deals with the improper and unauthorized creation of a voluntary unit, the interpretation of a contract between the parties relating to the voluntary pooling clause contained therein, and the effect of operations on an improperly created and unauthorized voluntary unit.

"In the instant case we are called upon to deal with a unit compulsorily created by an order of the Commissioner of Conservation, and the interpretation and effect of a contract between the parties as to the obligations flowing therefrom but which has been substituted for and superseded by an order of the Commissioner of Con-

servation. It is apparent therefore that the Wilcox case is neither controlling nor analogous to that present here." *Delatte v. Woods, supra,* p. 289.

The decisions of the Louisiana Supreme Court in the *Sohio* and the *Delatte* cases, *supra,* make it clear beyond any doubt that the inclusion of the north half of the Miller Lease in the conservation unit around the shut-in Durke well prior to the May 5, 1957 rental-paying date maintained the entire Miller Lease in force without the payment of any delay rental until May 5, 1959, the end of the primary term, regardless of any contrary language in the Miller Lease, the provisions of which were superseded by the order of the Commissioner of Conservation. Prior to May 5, 1959, the Durke well in the unit including the north half of the Miller Lease and the Bernard well in the unit including the south half of the Miller Lease, were both placed on production (R. 45, 46). This maintained the lease in force as long as these wells produced as provided in Paragraph 2 of the lease (R. 60, 61).

B. THE COURT OF APPEALS ERRED IN HOLDING THAT SUFFICIENT RENTALS WERE NOT PAID PRIOR TO MAY 5, 1958 TO MAINTAIN THE ENTIRE LEASE IN FORCE, BUT, IN ANY EVENT, AT LEAST THE NORTH HALF OF THE LEASE WAS MAINTAINED BY ITS INCLUSION IN THE CONSERVATION UNIT AROUND THE SHUT-IN GAS WELL.

Paragraph 2 of the Miller Lease provides that it shall continue in force for three years, called "primary term" (R. 60, 61) from the effective date, which is May 5, 1956 (R. 58). However, Paragraph 3 pro-

vides that the lease shall terminate on May 5, 1957 unless on or before said date the lessee commences the drilling of a well or pays a delay rental of $3900. Under this language, the timely commencement of a well by the lessee, even though it turned out to be a dry hole one month later, would maintain the lease in force until May 5, 1958. Instead of commencing a well, the lessee paid the delay rental which was unnecessarily paid because prior to the rental date the north half of the lease was included in a conservation unit around the Durke well which, pursuant to the *Sohio* and *Delatte* cases, *supra*, held the entire lease until May 5, 1959, the end of the primary term, without payment of any delay rentals. Even if, as the District Court held, a delay rental payment of $7800 was required on or before May 5, 1958 to maintain the Miller Lease in force beyond that date, such requirement was satisfied by the $3900 unnecessarily paid on April 20, 1957 (R. 42), and the second $3900 paid on April 23, 1958 (R. 43). The District Court further erred in holding that certain language, taken out of context, in Paragraph 9 of the Miller Lease constituted a Pugh clause which divided the lease into two leases with the result that in order to maintain the lease after May 5, 1958, the lessee was required to pay "in lieu" royalty on the north half of the lease and to pay a delay rental on the south half of the lease. There is no provision in the lease for the payment of "lieu royalty" in a situation where a portion of the lease is included in a conservation unit around a shut-in well, and even if there were such a provision in the Miller Lease, the inclusion of the north half of the lease in the unit around the shut-in Durke well would have maintained the lease without the pay-

ment of any "lieu royalty" under the decisions in the *Sohio* case and the *Delatte* case. Thus, no payment of any kind was required to maintain the lease in effect as to the north half thereof on or before May 5, 1958. Even if the District Court was correct in holding that the language, taken out of context, in Paragraph 9 of the Miller Lease required the payment of $3900.00 on or before May 5, 1958 to maintain the south half of the lease in effect, this amount was paid on April 23, 1958 (R. 43) and, even under the District Court's interpretation of the lease, maintained the south half of the lease in force until May 5, 1959, at which time every acre of the lease was participating in production.

As pointed out hereinabove, the success of the Louisiana Oil and Gas Conservation statute in preventing the drilling of unnecessary wells by the formation of compulsory units led to the inclusion in oil and gas leases of a provision making it possible for the lessee to establish voluntary drilling units combining the lease or portions thereof with other leases or portions thereof with the result that drilling operations on any portion of the unit satisfied the drilling obligations of all leases, portions of which had been included in the voluntary drilling unit. In construing leases containing a provision permitting voluntary pooling, the Louisiana Courts have consistently held that where a portion of a lease has been included in a unit, production from the unit would continue the entire lease in force, whether or not the unit well was drilled on a portion of the leased acreage. The courts reason that because the obligation of the lessor and the lessee in an oil and gas lease are indivisible, production which would extend the term of

any portion of the lease would extend the entire lease. This result was objectionable to lessors and an additional clause was added to the leases, which came to be known as the Pugh clause named after the lawyer who is generally credited with having originated it. The Pugh clause provides in effect that production from a voluntary unit will not maintain that portion of the lease outside the unit and that the portion outside the unit can be maintained only by drilling or by the payment of a proportionately reduced delay rental. Generally speaking, an oil and gas lease without a voluntary pooling provision does not contain a Pugh clause. The Miller Lease not only does not contain a voluntary pooling provision, but it specifically prohibits the pooling of the leased premises with any other land without the written consent of the lessor. (R. 73.) Since the Miller Lease prohibits voluntary pooling, it was not necessary for it to have a Pugh clause as generally understood and there is no Pugh clause in the Miller Lease. The language in Paragraph 9 of the Miller Lease which the District Court construed as a Pugh clause, reads as follows:

> "* * * provided no portion of the leased premises shall be retained under a spacing or allocation order of the Louisiana Department of Conservation other than that portion located within the unit or units which have at that time been formed by the Louisiana Department of Conservation, and the inclusion of a portion of the lands herein leased in a unit or units shall not be deemed sufficient to hold the remainder of the

lands not included in said units without the compliance with the requirements of this lease for the retention of the privileges herein granted, * * *" (R. 72).

The above language is contained in a proviso which refers to the language preceding it and when the whole of Paragraph 9 (R. 71-73) is read together, it is seen that it deals only with the situation where the lessee, after having begun "to exploit the premises as understood herein" decides to discontinue drilling operations, in which event the lessee is granted the right to retain certain acreage around wells which are producing or which are capable of producing. Under the settled rules of statutory construction, every portion of Paragraph 9 must be read together with every other portion to determine the meaning of Paragraph 9. There is no evidence in the record to show that Kellerman ever decided to discontinue operations and ever selected any acreage to be retained around any well. Consequently, Paragraph 9 cannot be construed to have the effect of dividing the Miller Lease into two leases so as to require the payment of delay rentals to maintain the south half of the lease in force. No Louisiana court has ever held that language similar to the language in Paragraph 9 relied on by the District Court divided a lease when only a portion thereof was included in a unit established by an order of the Commissioner of Conservation. In *Smith v. Carter Oil Company*, 104 F. Supp. 463 (W.D. La. 1952), the lease contained a voluntary pooling provision with a Pugh clause. A well was drilled on a unit including a por-

tion of the leased premises but not on the leased premises. The lessee did not create the unit by declaration, but obtained a forced pooling order from the Commissioner of Conservation. The court held that since the lessee had not invoked the pooling clause, the provisions in that clause for the division of the lease were not applicable and that, therefore, the lease remained an indivisible contract which was maintained in force by unit production as to the lands both within and without the unit. By the same reasoning, since there is nothing in the record to show that Kellerman has invoked the provisions of Paragraph 9 or ever decided to discontinue operations under the lease or ever selected any acreage to be retained around producing or shut-in wells, the provision in Paragraph 9 relied on by the District Court was not applicable and consequently the lease remained an indivisible contract which was maintained in force during the primary term in accordance with the decisions in the *Sohio* and *Delatte* cases, *supra*.

However, even if the Court of Appeals was correct in deciding that a portion of a sentence in Paragraph 9 of the lease constitutes a Pugh clause with the result that delay rental payments were required to maintain the south half of the lease in effect and that such rental payments were not sufficient, the Court of Appeals was obligated to give the same effect to the inclusion of the north half of the lease in a conservation unit as would be given to such an event by the courts of Louisiana. There is no conflict in the Louisiana decisions on this question and the law is well settled by the *Sohio* and *Delatte* cases that when a portion of a lease is included in

a unit around a shut-in well by an order of the Commissioner of Conservation, it is constituted a developed area by Section 8 (b) of the Louisiana Conservation Law and the lease is maintained in effect without the payment of delay rentals or drilling operations "as long as a well is located therein which is capable of producing oil or gas in paying quantities." LSA-R.S. 30:9(B). This provision of the Louisiana Conservation Statute supersedes any provision of the lease in conflict therewith. Consequently, there was no question but that the north half of the lease was maintained in effect throughout the primary term without the payment of any delay rental or the undertaking of any drilling operations by the lessee. Before the end of the primary term the unit well was placed on production which served to continue the lease in force. Under the Erie doctrine, the Court of Appeals was obligated to refuse to cancel the lease at least as to the north half thereof.

C. IF KELLERMAN FAILED TO PAY THE CORRECT RENTAL, THE COURT OF APPEALS ERRED IN REFUSING TO LET KELLERMAN CORRECT THE ERROR OR, IN THE ALTERNATIVE, IN REFUSING TO HOLD THAT MILLER HAD WAIVED HIS RIGHT TO HAVE THE LEASE CANCELLED BY REMAINING SILENT FOR ALMOST FIVE YEARS AFTER ACCEPTING PAYMENT OF THE DELAY RENTAL.

It seems clear, under the doctrine announced in the *Sohio* and *Delatte* cases, *supra*, that the inclusion of the north half of the Miller Lease in the conservation unit around the Durke well maintained

the entire lease in effect without the payment of any delay rental during the primary term of the lease. However, if the Court of Appeals was correct in holding that payment of delay rental was necessary to maintain the south half of the lease and that sufficient delay rental was not timely paid, the Court of Appeals erred in not giving Kellerman a reasonable opportunity to correct the mistake after notice of the error in the rental payment, as was done by the Louisiana Supreme Court in *Jones v. Southern Natural Gas Company*, 36 So.2d 34 (La. S.Ct. 1948).

In the *Jones* case the original lease covered approximately 518 acres and provided for an annual delay rental of $1.00 per acre. The lease also provided that in the event of an assignment of a portion of the lease, the rental payments were to be apportioned ratably according to the surface areas held by assignor and assignee. The defendant acquired a portion of the lease by assignment and paid the lessee $300 as the delay rental due for 1944. Defendant arrived at this amount by computing the area which it believed it had acquired by the assignment. The lessee accepted this payment without protest. Shortly prior to the rental paying date in 1945, the defendant again paid the lessee the sum of $300 as delay rental and approximately one month after receipt of this payment, the lessor notified defendant that the correct delay rental was $322.63 and demanded a release of the lease on the grounds that it had terminated for non-payment of the correct delay rental for 1944 and 1945. Approximately three

months thereafter, defendant mailed its check to the lessor for the difference between the amount it had paid as delay rental for those two years and the amount claimed by the lessor to have been due. Thereafter, the lessor sued for cancellation of the lease for non-payment of the proper delay rental. The evidence showed that several different surveys had been made of the portion of the lease assigned to defendant and each survey showed a different acreage for the portion of the lease assigned to defendant. The court refused to grant cancellation of the lease because it felt that the lessee had made a reasonable mistake in the payment of the delay rental and should have a reasonable time after receiving notice from the lessor of the incorrect payment within which to rectify the error. In arriving at this conclusion the court said:

> "There is ample authority for the proposition that considerations of equity may prevent a forfeiture of a mineral lease where the failure of the lessee to pay the full amount of the delay rentals, or his failure to pay it within the time stipulated, is the result of a mistake on his part, and where the circumstances are such that the mistake is a pardonable one, and particularly where the mistake is a mutual mistake on the part of both the lessor and the lessee. In such cases equity requires that when the lessor learns of the mistake he should promptly inform the lessee of the mistake and give the latter an opportunity to correct it immediately, before he, the lessor, can demand a forfeiture for nonpayment of the rental within the time stipulated. See *Monarch Gas Co. v.*

Roy, et al, 81 W.Va. 723, 95 SE 789; and *Gloyd v. Midwest Refining Co.*, 10 Cir., 62 F. 2d 483." *Jones v. Southern Natural Gas Company, supra*, p. 38.

If there was ever a case where the amount of delay rental due, if any, under an oil and gas lease was uncertain, it is the case which is the subject of this application for a writ of certiorari. Obviously, the Court of Appeals had difficulty in determining what delay rentals, if any, were due for the year commencing May 5, 1957 and for the year commencing May 5, 1958, because approximately two months after the case was argued, the Court suggested that the parties file supplemental briefs discussing those provisions of the lease pertaining to the lessees' drilling obligations and the penalties for the breach thereof. There was no need for considering those provisions of the lease unless the lease had been maintained in effect by the inclusion of a portion thereof in the conservation unit around the Durke well, pursuant to the decision in the *Sohio* and *Delatte* cases, *supra*, or unless the Court of Appeals felt that the lease had been maintained in effect by the payment of proper delay rentals, or by a combination of the two events. The District Court likewise had difficulty in determining the amount of delay rental, if any, that was due on May 5, 1958 as evidenced by the fact that after all the briefs had been filed the District Court directed two letters to counsel dated February 11th and 13th, 1964, requesting supplemental memoranda on certain questions including the question as to whether any delay rental was due under Paragraph 3 of the lease after

the inclusion of the north half of the lease in the conservation unit. (R. 202) The difficulty which both the Court of Appeals and the District Court had in determining whether the proper amount of delay rental had been paid for the year commencing May 5, 1958 is all the proof that is needed to show that there was great uncertainty in the minds of the Court concerning the amount of delay rental, if any, due for the year 1958. Surely, if the Court of Appeals and the District Court, after months of study, had such difficulty deciding the rental question, Kellerman can be pardoned for having made a mistake in the delay rental payment for 1958, and should be given an opportunity to correct the erroneous payment pursuant to the holding of the Louisiana Supreme Court in the *Jones* case, *supra.*

The Court of of Appeals' affirmance of the District Court's refusal to apply the equitable doctrine of the *Jones* case, *supra,* is apparently based on the District Court's reasoning that the delay rental provisions of the Miller Lease were so clear and unambiguous that there was no basis for an erroneous payment. The District Court sought to distinguish this case from the *Jones* case on the grounds that in the *Jones* case the amount of delay rental was rendered uncertain because of a conflict in surveys showing the amount of acreage covered by the lease whereas in this case and the cases cited by the District Court (R. 204), the exact amount of the delay rental was stated in the lease. The error committed by the District Court and concurred in by the Court of Appeals was in failing to recognize that under

the doctrine of the *Sohio* and *Delatte* cases, *supra*, the delay rental provision of the Miller Lease was superseded by the conservation order which placed the north half of the lease in the conservation unit around the Durke well. According to the *Delatte* case no delay rental was due thereafter on any portion of the lease unless certain language in Paragraph 9 divided the lease into two leases so as to require the payment of delay rental to hold the south half of the lease. It is Kellerman's contention that if any delay rental was necessary to hold the south half of the lease, which is denied, sufficient delay rental was paid. In any event, the amount of delay rental, if any, due for the year 1958 was so uncertain after the issuance of the conservation order that the Court of Appeals erred in not applying the doctrine of the *Jones* case, *supra*. The cases relied on by the District Court in refusing to apply the doctrine of the *Jones* case are not at all pertinent because in those cases (1) the lessee paid absolutely no rental to the lessor and (2) made no effort to pay any rental after being given notice of the failure to pay and (3) the rental provisions of the leases had not been superseded by an order of the Commissioner of Conservation as in the case under discussion. Although the Court of Appeals in its *per curiam* commented on the irreconcilable conflicts in the oil and gas law in Louisiana, there is no case in Louisiana where the court has cancelled a lease for non-payment of delay rental where the lessee has in good faith made some rental payment after a portion of the lease has been included in a con-

servation unit around a shut-in gas well as was the situation in this case.

In addition to the Court of Appeals' error in failing to apply the doctrine of the *Jones* case, *supra,* the court also erred in failing to follow the settled Louisiana law that the lessor may be estopped or may waive his right to have a lease cancelled for failure to pay the correct amount of delay rental where the lessor fails to complain about the improper payment until after the lessee has drilled a well or wells on the leased property. There is no conflict as to the law of Louisiana in this situation. There is no Louisiana case which has decreed cancellation of an oil and gas lease for non-payment or improper payment of delay rentals where the lessor has remained silent until after the expiration of the primary term and has accepted royalty payments from wells on the leased land or on a unit including the leased land. On the other hand, the Louisiana Supreme Court in *Dellinger v. Smith,* 77 So. 947 (La. S.Ct. 1918), and *Risinger v. Arkansas-Louisiana Gas Co.,* 3 So.2d 289 (La. S.Ct. 1941), refused to cancel a lease for non-payment of delay rental after the lessee had drilled a well on the land. Under Section 8(b) of the Louisiana Conservation Statute, LSA-R.S. 30:9(B), the inclusion of the north half of the lease in this case in a conservation unit around a shut-in gas well had the same effect as though the lessee had drilled on the leased land. Consequently, the court violated the Erie doctrine in failing to apply the doctrine of the *Dellinger* case and the *Risinger* case to the facts in this case where the lessor waited almost five years after the

alleged incorrect payment and more than four years after every acre of the lease had been participating in production before complaining about the alleged error in the delay rental payment.

The error committed by the District Court and the Court of Appeals in this case resulted from the failure of these Courts to give any effect to the order of the Commissioner of Conservation of Louisiana, which order included the north half of the Miller Lease in a unit around the shut-in Durke well. Under the doctrine of *Erie Railroad Co. v. Tompkins*, 304 U.S. 78, these Courts were obligated to give the same effect to the order of the Commissioner of Conservation as would have been given to such order by the Louisiana courts. Under the decisions in the *Sohio* and *Delatte* cases, *supra,* the inclusion of the north half of the Miller Lease in a unit around the shut-in Durke well, pursuant to the order of the Commissioner of Conservation, maintained the entire lease in effect during the primary term without the payment of any delay rental. The minimum effect that can be given to the order of the Commissioner of Conservation is that the inclusion of the north half of the Miller Lease in the unit around the Durke well maintained only the north half of the lease in effect without the payment of delay rentals, although there is no Louisiana jurisprudence justifying this limitation of the effect of the order of the Commissioner of Conservation. Petitioners feel very strongly that the entire lease was maintained in effect by the order of the Commissioner of Conservation without the payment of any delay rental and certainly there

is no justification for cancelling the lease insofar as the north half thereof is concerned.

CONCLUSION.

WHEREFORE, petitioners pray that a writ of certiorari issue from this Honorable Court to review the judgment of the United States Court of Appeals for the Fifth Circuit in R. E. Kellerman, et als v. Preston J. Miller.

Respectfully submitted,

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